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EVALUATION OF THE EFFECT OF THE BOEING, ROCKWELL,
AND MCDONNELL DOUGLAS BUSINESS COMBINATION ON
PENSION PLANS AND DOD-FUNDED PENSION ASSETS

Report No. 99-156

May 13, 1999

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Office of the Inspector General
Department of Defense

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Acronyms

A&D	Aerospace and Defense
CAS	Cost Accounting Standards
CIPR	Contractor Insurance/Pension Review
DCAA	Defense Contract Audit Agency
DCMC	Defense Contract Management Command
DLA	Defense Logistics Agency



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202

May 13, 1999

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
DIRECTOR, DEFENSE LOGISTICS AGENCY
DEFENSE CORPORATE EXECUTIVE FOR THE BOEING
COMPANY

SUBJECT: Evaluation of the Effect of the Boeing, Rockwell, and McDonnell Douglas Business Combination on Pension Plans and DoD-Funded Pension Assets (Report No. 99-156)

We are providing this report for information and use. In preparing the final report, we considered comments from the Director, Defense Logistics Agency, and the Assistant Director, Policy and Plans, Defense Contract Audit Agency, on the draft report. Input from the Boeing Defense Corporate Executive was included in the Defense Logistics Agency comments.

Management comments on the draft report met the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, no additional comments are required.

We appreciate the courtesies extended to the evaluation staff. Questions on the evaluation should be directed to Mr. Kenneth H. Stavenjord at (703) 604-8952 (DSN 664-8952) (kstavenjord@dodig.osd.mil) or Mr. Ronald R. Meissner at (703) 604-8911 (DSN 664-8911) (rmeissner@dodig.osd.mil). If management requests, we will provide a formal briefing on the evaluation results. See Appendix B for the report distribution. The evaluation team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 99-156
(Project No. 8PT-9009)

May 13, 1999

Evaluation of the Effect of the Boeing, Rockwell, and McDonnell Douglas Business Combination on Pension Plans and DoD-Funded Pension Assets

Executive Summary

Introduction. This report is being issued by the Inspector General, DoD, to evaluate the effect of the Boeing, Rockwell, and McDonnell Douglas business combination on pension plans and DoD-funded pension assets.

Evaluation Objectives. The overall objective was to determine whether DoD pension costs and DoD-funded pension assets, which represent the accumulation of pension costs charged to Government contracts, were properly protected in the business combination of Boeing, Rockwell, and McDonnell Douglas.

We evaluated each of the pension programs with different levels of benefits and plan provisions, different funding ratios between assets and liabilities, different percentages of Government and commercial funding, and different characteristics of plan participants. We determined whether contractors were maintaining the pension records required under Cost Accounting Standard 9904.413-50(c)(7); whether Government auditors were reviewing pension records as required; and whether the Government audit report and the report issued by the Defense Contract Management Command, Contractor Insurance/Pension Review, properly documented the pension costs and pension assets and liabilities.

Evaluation Results. No material discrepancies or problems were found in the Cost Accounting Standard 9904.413-50(c)(7) pension records maintained by the contractors, in the required reviews of pension records, and in the advance agreements between the Government and the contractors concerning the transfer of pension assets and liabilities. However, two issues have been identified. The first issue is an apparent discrepancy in the allocation of pension assets between the Boeing Company (Boeing) and Rockwell. Further evaluation is required, and the results will be addressed in a separate report.

The second issue is the impact of the new Boeing pension plan on Government pension costs and pension fund assets, particularly in view of the waivers of Cost Accounting Standards that were requested by Boeing and granted by the Cost Accounting Standards Board. The Government does not have the information required to evaluate future cost projections for Boeing pensions. Boeing established a new pension plan in January 1999 and has not adequately disclosed the details of the plan and projected costs. Further, Boeing has not disclosed the timing and effects of extending the new pension plan to former employees of Rockwell International Corporation. As a result, there is no accountability for the allocation and projected use of approximately \$3 billion of Government surpluses in funding the new Boeing pension plan.

Summary of Recommendations. We recommend that the Boeing Defense Corporate Executive request that the Defense Contract Audit Agency and the Defense Contract Management Command, Contractor Insurance/Pension Review Team, review and determine the impact of the restructured Boeing pension program on future Government contract pension costs; review the method of allocating Government-funded pension assets to segments of the plan; and review the timing and effects of extending the new pension plan to former Rockwell Corporation employees. We also recommend that the Boeing Defense Corporate Executive initiate a special Contractor Insurance/Pension Review to evaluate the contractor's compliance with provisions of the Cost Accounting Standards and the Federal Acquisition Regulation applicable to the contractor's group insurance program and property and liability insurance programs.

Management Comments. The Defense Logistics Agency and the Defense Contract Audit Agency concurred with the evaluation recommendations. In response to our recommendation for a Contractor Insurance/Pension Review to cover the specifically identified pension issues, the Director, Defense Logistics Agency stated that a review had been scheduled for April 1999. The estimated completion date for this action is July 31, 1999. Subsequent to the receipt of comments, it was determined that the review has been rescheduled for May 1999 with a September 1999 estimated completion.

In response to our recommendation for a Contractor Insurance/Pension Review to cover the contractor's group insurance program and property and liability plans, the Director, Defense Logistics Agency stated that a Contractor Insurance/Pension Review had been scheduled for April 1999. Again, subsequent to the receipt of comments, it was determined that the review has been rescheduled for May 1999 with a September 1999 estimated completion. In addition, the Defense Contract Audit Agency indicated that a Cost Accounting Standard 416, Accounting for Insurance Costs, compliance audit was conducted with the assistance of the Defense Logistics Agency Insurance Specialist. An incurred cost audit of Boeing's claimed 1997 insurance costs was also conducted. The Deputy Director, Defense Logistics Agency, confirmed that the Defense Logistics Agency supplied technical support during the audit and considered this participation as a Special Contractor Insurance Pension Review. He commented that no major findings have been reported as a result of this review.

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Background

Pension accounting is unique in that the majority of the actual pension accounting transactions are not entered on the official financial accounting books and records of a public corporation. Financial Accounting Standard (FAS) 87 controls the way corporations determine and record pension information for financial accounting purposes. The Employee Retirement Income Security Act of 1974 (ERISA), as amended, provides for true pension accounting on a plan basis. The annual pension expense recorded on a corporate income and expense statement in accordance with FAS 87 does not correspond to the actual annual pension contribution required under ERISA. The balance sheet accounting under FAS 87 is recorded net of the pension plan assets and actuarial liability determined according to FAS 87. The FAS 87 balance sheet accounting also differs from the balance sheet accounting maintained under ERISA.

Major Government contractors must also comply with the Cost Accounting Standards (CAS), specifically CAS 412, Composition and Measurement of Pension Cost, and CAS 413, Adjustment and Allocation of Pension Cost. These Cost Accounting Standards provide for Government contract pension accounting, which closely parallels the ERISA accounting for pension plans. The major difference between CAS and ERISA is that CAS provides for segment accounting, which can be more detailed if one pension plan has several segments. The CAS 413, in addition to being a Cost Accounting Standard, is also an asset accountability standard under CAS 9904.413-50(c)(7).

Defense Contract Audit Agency. The Defense Contract Audit Agency (DCAA) performs all necessary contract audits for DoD and provides accounting and financial advisory services regarding contracts and subcontracts to all DoD Components responsible for procurement and contract administration.

Defense Contract Management Command. The Defense Contract Management Command (DCMC), Defense Logistics Agency (DLA), performs price/cost analyses, overhead and contractor system reviews, financial services, property and plant clearance, transportation and packaging, and termination settlements for DoD. The Defense Contract Management Command also provides program and technical support by analyzing costs, schedules, and technical performance of contractor programs and systems. The Defense Corporate Executive – Boeing is the DCMC primary point of contact for contract administration matters with Boeing.

Contractor Insurance/Pension Review Teams. A Contractor Insurance/Pension Review (CIPR) is initiated at the request of the Defense Corporate Executive. The CIPR team consists of a joint DCAA and DCMC team comprising DCAA auditors and DCMC insurance pension specialists. The CIPR team is responsible for conducting a CIPR, which is a comprehensive review of a contractor's insurance program, pension plans, other deferred compensation plans and related policy, procedures, practices and costs.

If a business combination (merger) occurs, the CIPR team must determine whether the contractor has complied with the special segment closing provisions of CAS 9904.413.50(c)(12). This requires an analysis of the contractor's calculation of the amount of pension assets and liabilities and the allocation of the assets and liabilities to the segments involved in the transaction. The asset and liability balances determine the basis for measuring the effect of the adjustment on previously determined pension costs required under CAS 9904.413.50(c)(12). The contractor's accounting for pension assets and liabilities must comply with the measurement and allocability requirements of CAS 412 and 413, and must be allocable, reasonable, and allowable as provided by FAR subpart 31.2.

The CIPR program review steps cover the key aspects of accounting for pension assets and liabilities for segment closings, benefit curtailments, and plan terminations.

Objectives

The objective of the evaluation was to determine whether DoD pension costs and DoD-funded pension assets, which represent the accumulation of pension costs charged to Government contracts, were properly protected in the business combination of Boeing, Rockwell, and McDonnell Douglas. See Appendix A for a discussion of the scope and methodology.

Impact of New Boeing Company Pension Plan

The Government does not have the information required to evaluate future cost projections for the Boeing Company's (Boeing's) pensions. Boeing established a new pension plan in January 1999 and has not adequately disclosed the details and projected costs of the plan. Further, Boeing has not disclosed the timing and the effect of extending the new pension plan to former Rockwell International Corporation (Rockwell) employees. As a result, there is no accountability for the allocation and projected use of approximately \$3 billion of Government surpluses in funding the new Boeing pension plan.

The Boeing, Rockwell, and McDonnell Douglas Combination

On July 31, 1996, Rockwell and Boeing entered into an agreement and plan of merger in which Boeing acquired Rockwell's Aerospace and Defense (A&D) business. The A&D businesses include all of Rockwell's Government contracting locations covered by CAS, except for the Collins businesses and certain corporate and A&D employees. On December 14, 1996, the Boeing Company acquired the McDonnell Douglas Corporation (McDonnell Douglas) as a wholly-owned subsidiary of Boeing.

Boeing. Boeing is one of the world's major aerospace firms. Boeing operates in two principal industries: commercial aircraft and defense and space. Commercial aircraft operations conducted through the Boeing Commercial Airplane Group include the development, production, and marketing of commercial jet aircraft and providing related support services to the commercial airline industry worldwide. Defense and space operations conducted through the Boeing Defense and Space Group include research, development, production, modification, and support of military aircraft and helicopters and related systems; space and missile systems; rocket engines; and information services, primarily through Government contracts. Approximately 75 percent of Boeing's 1996 revenues were from the commercial aircraft segment, and 25 percent were from the defense and space segment.

McDonnell Douglas. McDonnell Douglas, its divisions, and its subsidiaries operate principally in four industry segments: military aircraft; missiles, space, and electronic systems; commercial aircraft; and financial services and other. For the year ended December 31, 1996, the military aircraft segment accounted for 57 percent of operating revenues; the missiles, space, and electronic systems segment for 16 percent; the commercial aircraft segment for 24 percent; and the financial services and other segment for 3 percent.

Operations in the first two industry segments are conducted primarily by McDonnell Douglas Aerospace and Military Transport Aircraft, unincorporated operating divisions of McDonnell Douglas. These operating divisions design,

develop, produce, and support military aircraft, tactical missiles, satellite launching vehicles, and defense electronic components and systems. Operations in the commercial aircraft segment are conducted by Douglas Aircraft Company, an unincorporated operating division of McDonnell Douglas, which designs, develops, produces, modifies, and sells commercial transport aircraft and related spare parts and support services.

Rockwell. Rockwell is engaged in research, development, and manufacture of many products. Prior to the sale of the Aerospace and Defense business to Boeing, 65 percent of the total sales of Rockwell were made to U.S. commercial and international customers, 20 percent were made under United States Government defense contracts and subcontracts, and 15 percent were made under contracts with the National Aeronautics and Space Administration (NASA) for space activities.

Rockwell divested its former Aerospace and Defense business to Boeing for approximately \$3.2 billion by means of a merger in which Rockwell's predecessor corporation became an owned subsidiary of Boeing. Rockwell business segments are engaged in research, development, and production of diversified products, as follows:

- Electronic Automation – industrial automation equipment and systems, including control logic, sensors, human-machine interface devices, motors, power and mechanical devices, and software products;
- Avionics and Communications – avionics products and systems and related communications technologies primarily used in commercial and military aircraft and defense electronic systems for command, control, communications, and intelligence;
- Semiconductor Systems – system-level semiconductor chipset solutions for personal communications and electronics markets, including chipsets for facsimile and personal computer data modems, wireless communications products such as global positioning systems, packet data, cordless and cellular chipsets, and automated call distribution equipment;
- Heavy Vehicle Systems – automotive components and systems for heavy- and medium-duty trucks, buses, trailers and heavy-duty off-highway vehicles; and
- Light Vehicle Systems – components and systems for light trucks and passenger cars.

Consolidated Companies. The combination of Boeing, Rockwell, and McDonnell Douglas has resulted in the corporate consolidation of three diverse pension programs involving billions of dollars of DoD-funded pension assets. Each of the pension programs has separate plans with different levels of benefits and plan provisions, different funding ratios between assets and liabilities, different percentages of Government and commercial funding, and different characteristics of plan participants, such as age, service, and ratios of active to retired participants.

Boeing's New Pension Plan. Boeing, Rockwell, and McDonnell Douglas have offered very different retirement packages. To unify the retirement program of the three merged companies, Boeing introduced a new type of retirement program known as an account balance plan. The full cost of the plan will be paid by the company. Retirement benefits that employees have earned under the original plans will be carried forward and made available at retirement. These previously earned benefits will continue to grow as an employee's salary grows. In addition to any original benefits an employee may have accrued, benefits will also be earned through the new plan effective on January 1, 1999, for Boeing and McDonnell Douglas employees. The effective date for Rockwell employees has not been determined.

Under the new plan, an amount will be credited to each eligible employee's account balance each year. The credit will equal a percentage of an employee's pay, including lump-sum payments and executive incentive compensation. The size of the credit as a percentage of pay will increase as an employee nears retirement. The account will also be credited with interest each year.

Boeing has stated that the new plan will provide retirement benefits comparable to those available through the three original companies. Current employees who remain with the company after January 1, 1999, will receive benefits under the new plan, in addition to benefits previously earned under the original plans.

At the time of retirement, these employees will receive monthly benefits based on the amount they have accrued in both retirement plans. According to Boeing projections, the combination of benefits under the two plans should be substantially the same as benefits under the original plans.

DoD Interest in Boeing's New Plan. Prior to the merger of Boeing, Rockwell, and McDonnell Douglas, the Government granted Boeing a waiver of the CAS. However, at the time the waiver was granted, the Government was unable to anticipate Boeing's introduction of a new pension program.

Cost Accounting Standards Waiver. On December 5, 1996, the CAS Board initially approved the requested waiver of the segment accounting requirements of CAS 9904.413-50(c)(3) relating to the acquisition of the Rockwell Aerospace and Defense business by Boeing. On February 3, 1997, the CAS Board issued an amended approval letter that modified certain conditions affecting the waiver. The following provisions of CAS 9904.413-50(c) (3) were waived:

Pension cost shall also be separately calculated for a segment under circumstances where:

(i) The pension plan for that segment becomes merged with that of another segment, or the pension plan is divided into two or more pension plans, and in either case,

(ii) The ratios of market value of the assets to actuarial accrued liabilities for each of the merged or separated plans are materially different from one another after applying the benefits in effect after the pension plan merger or pension plan division.

Conditions. The CAS Board granted the waiver contingent on certain conditions it considered necessary to ensure proper accounting for period costs and the traceability of the Government's interests. These conditions are:

- (1) Although pension costs for the Boeing Company Defense and Space Group (D&SG), including Boeing North America (BNA), will be computed based on the combined assets and liabilities of all three plans as if they had formally merged, Boeing must maintain records of contributions, benefits, earnings, transfers, etc. for each pension plan as required by CAS 9904.413-50(c)(7) so that a segment closing adjustment pursuant to CAS 9904.413-50(c)(12) can readily be calculated. This will also document the change in funding levels between the pension plans as the company integrates and absorbs the BNA operations into its existing D&SG operations. This accounting convention will require an explicit recognition of the amount of total actuarial surplus in the BNA pension plan attributable to the BNA segments as it is used to offset pension costs attributable to the D&SG segment for the BCERP and BHP. This condition will expire when the three pension plans sponsored by Boeing achieve the same funding level at the D&SG segment, or when the merged plan comes out of a "full-funding" condition as measured by the Assignable Cost Limitation.
- (2) For potential segment closings and other oversight purposes, Boeing must maintain a separate memorandum record of the Government's interest in the BNA pension surplus. For these purposes, Boeing will initially determine the amount of the surplus in the BNA pension plan attributable to contracts subject to CAS 9904.413 of the former Rockwell Aerospace & Defense business as of January 1, 1997, hereafter referred to as the BNA surplus. This BNA surplus will be adjusted at least annually to reflect changes that are due to the plan's normal operations (e.g., accrued interest based on the pension plan's valuation interest assumption, experience gains and losses, and plan provision changes) which are attributable to contracts subject to CAS 9904.413. In addition, by memorandum record Boeing shall show a reduction against the BNA surplus in an amount equal to pension costs of the D&SG segment of the BCERP and BHP which would have been attributable to contracts subject to CAS 9904.413 in the D&SG segment, if the three plans had not been merged. This condition shall expire when the BNA surplus is reduced to zero.
- (3) After condition (1) expires, if two or more segments have materially different levels of pension benefits or benefit eligibility rights, then in accordance with CAS 9904.413-50(c)(2)(ii) there shall be an initial allocation of assets to those segments and pension costs shall be separately determined for those segment(s).
- (4) If the three pension plans merge for ERISA purposes, this waiver shall expire when conditions (1) and (2) have expired.

(5) The contracting parties shall agree that there will be no pension cost charged to U.S. Government contracts for these three CAS-covered defined-benefit plans during the period of full funding.

Boeing requested the waiver because it wanted the benefits of combining the Boeing and Rockwell plans for CAS purposes without an actual merger of the plans in accordance with ERISA. The combination of the plans for CAS purposes allows for certain consolidations of pension costs and pricing under Government contracts. However, the CAS waiver applies only to the Boeing and Rockwell combination and does not include the McDonnell Douglas pension program.

Pension Benefits to the Government. The benefit of the waiver to the Government is that, since the acquired pension funds will be hypothetically merged with Boeing's funds in order to compute the required contribution amounts, Boeing's total pension expense should be lower. The Government should directly benefit in that the Government would not be required to pay a higher pension cost than if the funds were not merged. At the time Boeing submitted its CAS 413 waiver request, Boeing also presented estimated cost projections to the Government. The projections showed a total cost avoidance of \$1.15 billion over the next 9 years, with the Government's share approximating \$809 million over the same period. This projection was based on the original pension plans. With the adoption of a new plan design as of January 1, 1999, the Government does not have adequate cost projections to determine how the new plan will affect future Government pension costs.

Disclosure of Plan Details and Projected Costs

Boeing has not disclosed the information necessary to evaluate the impact of the new plan on the Government, in relation to what was presented to the Government when requesting the CAS 413 waiver.

Annual Pension Costs. In response to our request for information on projected pension costs, the Boeing response of July 21, 1998, stated that the projected annual normal costs for the original and new plans had been computed; however, the data were not readily available. Instead, the Boeing response provided an incomplete summary of the plan's total liability. A summary of liability information was provided for the Boeing and McDonnell Douglas portions of the new plan, but no information was provided in regard to the integration of Rockwell into the new plan. Disclosure of the plan liability information without the projected cost data does not provide the Government with the cost and pricing information needed to evaluate projected pension costs according to CAS 412, Composition and Measurement of Pension Cost.

Allocation of Pension Plan Assets. In response to our request for a description of the allocation of plan assets between the original plans and the new plan, Boeing stated that the issue had not been decided. Boeing officials further stated that in September 1998, they planned to begin the actuarial computations to determine asset allocation and early modeling of segment

allocation. We are concerned about the lack of an asset allocation plan at this stage of plan implementation. Because the asset balance is an integral part of any calculation of pension costs, the assets must be allocated by segment before any segmented pension cost information can be calculated.

Potential Consequences

Boeing has not proposed a method of allocating assets between the original pension plans and the new pension plan. The fact that the Government has no asset allocation data to review creates uncertainty as to the accountability or traceability of the Government's interests in pension plan surpluses between the original plans and the new Boeing pension plan. The Government also has been unable to review any meaningful pension costing information and is consequently at risk of incurring increased future pension costs because of changes in the Boeing pension plan. The Government is also at risk because the Rockwell pension fund represents a substantial portion of the new Boeing pension program, and no information regarding the incorporation of Rockwell into the new pension plan has been made available for Government review.

Recommendations, Management Comments, and Evaluation Response

- 1. We recommend that the Boeing Defense Corporate Executive request that the Defense Contract Audit Agency and the Defense Contract Management Command, Contractor Insurance/Pension Review Team:**
 - a. Determine the costs due to changes in the Boeing Company pension plan and ensure that the Government's future pension cost estimates have not materially changed from those projected at the time the waiver under Cost Accounting Standard 9904.413-50(c)(3) was granted.**
 - b. Review the Boeing Company's pension accounting to determine whether the Boeing Company is in compliance with the conditions of compliance set by the Cost Accounting Standards Board for the waiver of Cost Accounting Standard 9904.413-50(c)(3).**
 - c. Determine whether the Boeing Company is maintaining the required asset records by segment after the initial allocation of assets, and whether the contractor is maintaining records of the portions of subsequent contributions, permitted unfunded accruals, income, benefit payments, and expenses attributable to each segment in accordance with Cost Accounting Standard 9904.413-50(c)(7).**
 - d. Determine the implementation plan and the effect of extending the new pension plan to former employees of Rockwell International Corporation.**

Management Comments. The Defense Logistics Agency and the Defense Contract Audit Agency both concurred with the evaluation recommendation. In response to our recommendation for a Contractor Insurance/Pension Review to cover the specially identified pension issues, the Director, Defense Logistics Agency stated that a review had been scheduled for April 1999. The estimated completion date for this action was July 31, 1999.

Evaluation Response. We agree with the comments from DLA and DCAA. Subsequent to the submission of the comments, the Defense Corporate Executive and DCAA informed us that the Contractor Insurance/Pension Review is now planned to be conducted during the period of May 1999 through September 1999.

2. We recommend that the Boeing Defense Corporate Executive initiate a special Contractor Insurance/Pension Review to evaluate compliance with Cost Accounting Standard 416 and Federal Acquisition Regulation provisions applicable to the contractor's group insurance program and property and liability insurance programs.

Management Comments. The Defense Logistics Agency and the Defense Contract Audit Agency both concurred with the evaluation recommendation. In response to our recommendation for a Contractor Insurance/Pension Review to cover the contractor's group insurance program and property and liability plans, the Director, DLA, stated that a Contractor Insurance/Pension Review had been scheduled for April 1999. In addition, it was reported by the Defense Contract Audit Agency that a Cost Accounting Standard 416, Accounting for Insurance Costs, compliance audit was conducted with the assistance of the Defense Logistics Agency Insurance Specialist. An incurred cost audit of Boeing's claimed 1997 insurance costs was also conducted. The Deputy Director, DLA, confirmed that the Defense Logistics Agency supplied technical support during the audit and considered this participation as a Special Contractor Insurance Pension Review. The Deputy Director, DLA, commented that no major findings have been reported as a result of this review.

Evaluation Response. The comments from DLA and DCAA were responsive. Subsequent to the submission of the comments, the Defense Corporate Executive and DCAA informed us that the Contractor Insurance/Pension Review is now planned to be conducted during the period of May 1999 through September 1999.

Appendix A. Evaluation Process

Scope and Methodology

We reviewed the primary salaried and hourly pension plans at Boeing, Rockwell, and McDonnell Douglas. We conducted the evaluation from January through October 1998 and reviewed data for the period September 1994 through July 1998. We determined the differences and similarities between plan benefit levels, plan provisions, plan funding levels, and actuarial valuation characteristics. We evaluated CAS 9904.413-50(c)(7), records of total segmented pension data maintained by the contractors, the format and content of the records, the contractor personnel responsible for maintaining the records, and the dates when the records were available to the Government. We also reviewed the segmented pension data obtained by DCAA auditors and DLA pension specialists during their oversight of contractor pensions.

As criteria, we used the requirements of CAS 412, Composition and Measurement of Pension Cost, and CAS 413, Adjustment and Allocation of Pension Cost.

Evaluating Standards. We conducted this evaluation in accordance with standards implemented by the Inspector General, DoD.

DoD-wide Corporate Level Government Performance and Results Act Goals. In response to the Government Performance and Results Act, the Department of Defense has established 6 DoD-wide corporate level performance objectives and 14 goals for meeting these objectives. This report pertains to achievement of the following objective and goal.

Objective: Fundamentally reengineer DoD and achieve 21st century infrastructure. **Goal:** Reduce cost while maintaining required military capabilities across all DoD mission areas. **(DoD-6)**

General Accounting Office High-Risk Area. The General Accounting Office has identified several high-risk areas in DoD. This report provides coverage of the Defense Financial Management and Defense Contract Management high-risk areas.

Use of Computer-Processed Data. We examined computer records from Boeing. Nothing came to our attention as the result of our evaluation that caused us to doubt the reliability of the computer-processed data.

Contacts During the Evaluation. We visited or contacted individuals and organizations within DoD. Further details are available on request.

Management Control Program

Review of the management control program was not within the scope of this evaluation. A CIPR is an integral part of the overall management control program. We noted that a CIPR had not been performed at Boeing in the last 5 years.

Summary of Prior Coverage

There has been no prior coverage in the last 5 years.

Appendix B. Report Distribution

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Relations, Committee on Government Reform

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Defense Logistics Agency Comments



IN REPLY
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DEFENSE LOGISTICS AGENCY
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8725 JOHN J. KINGMAN ROAD, SUITE 2539
FT. BELVOIR, VIRGINIA 22030-6221

REF ID: A91

Dated
Feb. 12, 1999

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING, DEPARTMENT OF DEFENSE

SUBJECT: Draft Audit Report of the Evaluation of the Effect of
the Boeing, Rockwell, and McDonnell Douglas Business
Combination on Pension Plans and DoD-Funded Pension
Assets (Project No. DPT-9009)

This is in response to your December 31, 1998, subject draft
report. If you have any questions, please contact Zora
Henderson, (703) 767-6272.

Encl

Sherila P. Raines
SHERILA P. RAINES
Team Leader, Liaison and Policy
Internal Review Office

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SUBJECT: Evaluation of the Effect of the Boeing, Rockwell, and McDonnell Douglas Business Combination on Pension Plans and DOD-Funded Pension Assets

FINDING: Impact of Boeing Company's New Pension Plan The Government does not have the information required to evaluate future cost projections for the Boeing Company's (Boeing's) pensions. Boeing is instituting a new pension plan in January 1999 and has not adequately disclosed the details and projected costs of the plan. Further, Boeing has not disclosed the timing and the effect of extending the new pension plan to former Rockwell International Corporation (Rockwell) employees. As a result, there is no accountability for the allocation and the projected use of over \$3 billion of Government surpluses in funding the new Boeing pension plan.

DIA COMMENTS: Concur. A Contractor Insurance/Pension Review (CIPR) is scheduled for April 1999. This review will report on (1) the reasonableness of future cost projections of the new pension plan, (2) the timing and effect of extending the new pension plan to former Rockwell International Corporation Employees, and (3) the impact on the pension plan's surplus.

RECOMMENDATION 1: We recommend that the Boeing Defense Corporate Executive (DCE) request the Defense Contract Audit Agency (DCAA) and the Defense Contract Management Command (DCMC), Contractor Insurance/Pension Review (CIPR) Team to:

- a. Determine the costs due to changes in the Boeing Company's pension plan and ensure that the Government's future pension cost estimates have not materially changed from those projected at the time of granting the waiver of Cost Accounting Standard 413
- b. Review the Boeing Company's pension accounting to determine whether Boeing is in compliance with the Cost Accounting Standards Board's waiver of Cost Accounting Standard 9904 413-50(c)(3) conditions of compliance
- c. Determine whether the Boeing Company is maintaining the required asset records by segment after the initial allocation of assets, and that the contractor maintains a record of the portion of subsequent contributions, permitted unfunded accruals, income, benefit payments, and expenses attributable to each segment in accordance with Cost Accounting Standard 9904 413-50(c)(7)
- d. Determine the implementation plan and the effect of extending the new pension plan to former Rockwell Corporation employees.

DIA COMMENTS:

1. a. Concur. Subsequent to the Inspector General (IG) review, we had received preliminary data from the company indicating the impact was minimal over the 10-year

period forecast as part of the CAS 415 waiver request. Based upon the DCE understanding of the pension plan provisions, this impact was considered immaterial and without impact on the period in which the plan was forecast to be in full funding. More detailed information provided January 15, 1999 will be reviewed by DCAA and DCMC CIPR personnel to provide assurance that the preliminary assessment was valid. Initial review of this data indicates no impact on funding status or government contract cost over the relevant forecast period after extending the new pension plan to former Rockwell employees. This indication comes from (1) the plan's favorable investment performance over the past year, and (2) the plan design which is less costly for newly hired employees.

1.b. Concur This action will be taken during the joint DCAA and DCMC CIPR scheduled for April 1999.

1.c. Concur This action will be taken during the joint DCAA and DCMC CIPR scheduled for April 1999.

1.d. Concur This action will be taken during the joint DCAA and DCMC CIPR scheduled for April 1999.

DISPOSITION: Action is ongoing. Estimated Completion Date: July 11, 1999

RFCOMMENDATION 2: We recommend that the Boeing Defense Corporate Executive initiate a special Contractor Insurance/Pension Review to evaluate compliance with the Cost Accounting Standard and Federal Acquisition Regulation provisions applicable to the contractor's group insurance programs and property and liability insurance programs.

DLA COMMENTS: Concur This action was accomplished in June 1998 subsequent to the Inspector General's review. A special CIPR was performed at that time in support of a DCAA request for support of programmed CAS 416 compliance audit. No major findings have been reported as a result of this review.

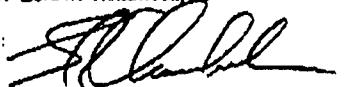
DISPOSITION: Action is considered complete

ACTION OFFICER: Patrick Ring, DCMDI-RO, (703) 767-3385

REVIEW/APPROVAL: Thomas J. Brunk, DCMC

COORDINATION: Zora M. Henderson, DPAI

DLA APPROVAL:



E.R. CHAMBERLIN
Rear Admiral, SC, USN
Deputy Director

Defense Contract Audit Agency Comments



IN REPLY REFER TO

DEFENSE CONTRACT AUDIT AGENCY
8725 JOHN J KINGMAN ROAD, SUITE 2135
FORT BELVOIR, VA 22060-6219

PAC 225/98-3

31 March 1999

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL, POLICY AND OVERSIGHT, DEPARTMENT OF DEFENSE

SUBJECT Response to DoDIG Draft Report on Evaluation of the Effect of the Boeing
Rockwell, and McDonnell Douglas Business Combination on Pension Plans
and DoD-Funded Pension Assets (Project No 8PT-9009)

As requested, we have reviewed the subject draft report. Our response to the draft follows

Recommendation 1.a.

Determine the costs due to changes in the Boeing Company's pension plan and ensure that the Government's future pension cost estimates have not materially changed from those projected at the time of granting the waiver of Cost Accounting Standard 413.

DCAA Comment.

Currently, no future pension costs are estimated for government contract purposes. The cognizant FAO is working with the Defense Corporate Executive (DCE) to obtain information from the Boeing Company to determine the impact, if any, due to the changes in the Boeing Company's pension plan. On 3 December 1998, the DCE and the auditor met with the Boeing actuary and requested a more detailed cost estimate of future pension costs. When the FAO receives this information, it will review the data to identify and evaluate any significant differences between the new estimate and the data that Boeing provided at the time of the CAS waiver.

Recommendation 1.b.

Review the Boeing Company's pension accounting to determine whether Boeing is in compliance with Cost Accounting Standards Board's waiver of Cost Accounting Standard 9904 413-50(c)(3) conditions of compliance.

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DCAA Comment.

Concur - The FAO is currently performing a joint review with the DLA insurance/pension specialist of the Boeing Company's compliance with the Cost Accounting Standards Board's waiver of 48 CFR 9904 413-50(c)(3)

Recommendation 1.c.

Determine whether the Boeing Company is maintaining the required asset records by segment after the initial allocation of assets, and that the contractor maintains a record of the portion of subsequent contributions, permitted unfunded accruals, income, benefit payments, and expenses attributable to each segment in accordance with Cost Accounting Standard 9904 413-50(c)(7)

DCAA Comments

Concur - The FAO has included in its FY 1999 Program Plan a CAS 413 compliance audit. As part of the CAS 413 audit, DCAA will review Boeing's pension accounting for compliance with CAS 413 50(c)(7)

Recommendation 1.d.

Determine the implementation plan and the effect of extending the new pension plan to former Rockwell Corporation employees

DCAA Comments.

In a 3 December 1998 meeting, Boeing indicated that it is in the process of drafting a formal plan for extending the Pension Value Plan to the Boeing North America (BNA) employees [former Rockwell Corporation employees], effective 1 July 1999. DCAA will review the extended Pension Value Plan to determine if the contractor is in compliance with the applicable CAS requirements. During this review, DCAA plans to request technical assistance from the DLA actuary

Recommendation 2.

We recommend that the Boeing Defense Corporate Executive initiate a special Contractor Insurance/Pension Review to evaluate compliance with the Cost Accounting Standard and Federal Acquisition Regulation provisions applicable to the contractor's group insurance program and property and liability insurance programs.

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DCAA Comment.

During FY 1998, the FAO performed a Cost Accounting Standard 416 (Accounting for Insurance Costs) compliance audit and an incurred cost audit of Boeing's claimed 1997 insurance costs. These audits were performed with technical assistance provided by the DLA insurance specialist. The technical evaluation included the group insurance and property and liability insurance programs. While the IG's recommendation is addressed to the DCE, the FAO will request technical assistance from the DLA insurance specialist in future audits of contractor insurance costs, where warranted.

If you have any questions, please contact Mr. Gerry Reichel, Program Manager, Accounting and Cost Principles Division, at (703) 767-3250



Lawrence P. Uhlfelder
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Policy and Plans

Evaluation Team Members

This report was prepared by the Audit Followup and Technical Support Directorate, Office of the Assistant Inspector General for Auditing, DoD.

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INTERNET DOCUMENT INFORMATION FORM

A . Report Title: Evaluation of the Effect of the Boeing, Rockwell, and McDonnell Douglas Business Combination on Pension Plans and DoD-Funded Pension Assets

B. DATE Report Downloaded From the Internet: 08/16/99

C. Report's Point of Contact: (Name, Organization, Address, Office Symbol, & Ph #): OAIG-AUD (ATTN: AFTS Audit Suggestions)
Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, VA 22202-2884

D. Currently Applicable Classification Level: Unclassified

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**F. The foregoing information was compiled and provided by:
DTIC-OCA, Initials: VM Preparation Date 08/16/99**

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